Securitization: An Alternative Funding Mechanism for the Microfinance Institutions

Shahadat Hossain[1*], Rubaiyet Hasan Khan[2]

[1]*Department of Finance, University of Chittagong, Bangladesh*
[2]*Curtin Business School, Curtin University, Australia*

**Corresponding author e-mail: Shahadat.Hossain@curtin.edu.au*

Abstract **- Despite microfinance has been widely appreciated as an informal financial mechanism to provide financial services to the poor people in developing countries, this sector is still lacking behind in fulfilling the demand gap due to the dearth of adequate funds. Securitization opens a new horizon that overcomes the funding barriers of microfinance through which the top tier Microfinance Institutions (MFIs) can accumulate funds to enlarge their portfolio without issuing any debt or equity. This paper is a desk study that synthesizes how securitization can be used in the funding of the MFI portfolio and what are the benefits and risks associated with securitization of microfinance portfolio. As a case study, we use the two examples of cross-border securitizations in the microfinance industry to diagnose the role of securitization in microfinance.**

Keywords *– Microfinance institution, funding, securitization, operational solution, financial mechanism*

ARTICLE INFO

Received 5 October 2018
Received in revised form 10 November 2018
Accepted 15 December 2018
Published 30 December 2018

I. Introduction

Microfinance has been widely appreciated as an informal financial mechanism to serve primarily the poor people (Cull, Demirguc-Kunt and Morduch, 2008). MFIs provide flexible financial services to these poor people and micro-entrepreneurs to fulfill their financing needs. In providing such financial services, the MFIs need huge funds to support their loan portfolios. Many of the MFIs proved that microfinance is a risk manageable business (Huttenrauch & Schneider, 2008). Moreover, there is mounting evidence that if properly structured and managed, and if a sufficient scale economy is achieved, providing financial services to the low income and poor people can generate a healthy return for MFIs (Huttenrauch & Schneider, 2008). However, there is a gap in demand for and supply of financial services to these poor people.

Lack of funding sources for the MFIs has been cited as the main barrier in their growth and client outreach (Huttenrauch & Schneider, 2008; Glaubitt et al., 2008). Funding for the MFIs varies depending on the type, size, and maturity of the MFIs, and the legal structure and the economy of the country (D'Espallier, Goedecke, Hudon & Mersland, 2017). The majority of the "green-field", and small MFIs are dependent on donor funds and grants. Some of the MFIs fuel their loan portfolios by mobilizing local savings and using their retained earnings. Equity, long-term debt or other sources of long-term funding and grants from the development financial institution's (DFIs) for technical assistance still play important role in the young and even in some commercially viable MFIs (Glaubitt et al., 2008). A few commercially profitable MFIs have shown the ability to enter into the capital market through initial public offering (IPO). But, external debt, grant or equity financing are not capable to meet the huge

demand for additional funds from the MFI borrowers. Moreover, it is not possible for every MFI to enter the local capital market. Further to this, globalization in current world imposes new challenges for microfinance funding, where understanding of local influences are crucial for success in business operations (Denner, 2018).

To upscale sustainable microfinance by integrating the MFIs fully into the international and local market, the MFIs have no choice other than increasing access to commercial funding. Securitization is one of the innovative structured funding alternatives through which the top-tier MFIs can fund their portfolio without issuing new debt or equity. Although it is used in conventional financial institutions, it is a new funding alternative to MFIs (Sonal & Soni, 2017). The literature on this issue, particularly in microfinance is very insignificant. To fill this gap, the main objective of this study is to evaluate and synthesize securitization as a new funding alternative for the MFIs. Specifically, this study aims to synthesize recommendations for the following issues relating to securitization in microfinance: a) what are the motives for securitization and the risks involved in it for the MFIs? b) to make a successful securitization, what are the key requirements? To answer these questions, this study uses explorative and analytical desk study. This study exemplifies the securitization transaction in microfinance and the benefits and costs associated with the securitization through case studies.

II. Literature review

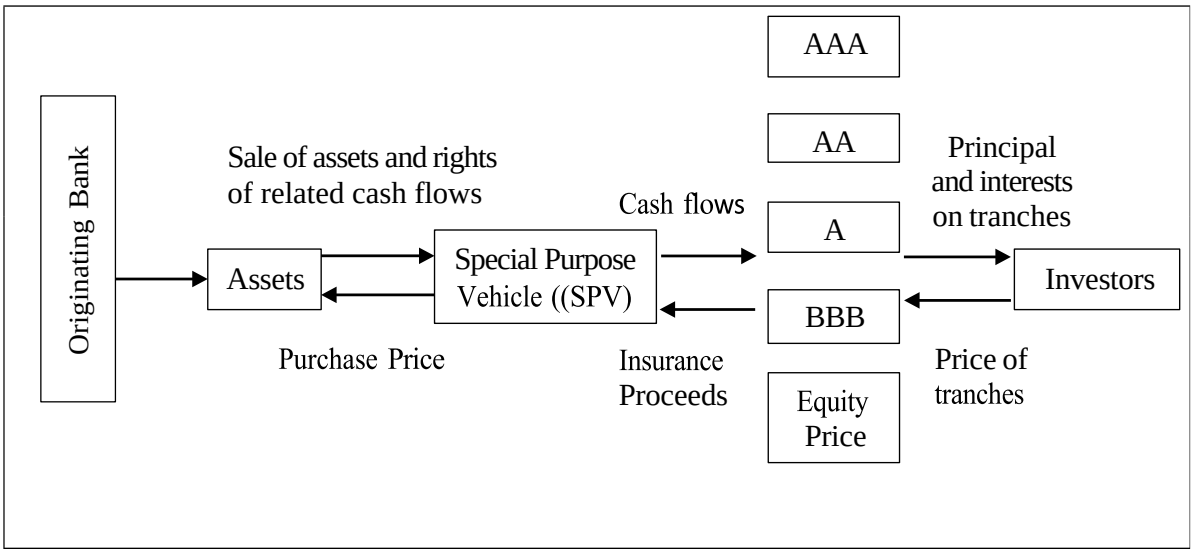
Securitization is the fastest growing form of structured finance. It serves to efficiently refinance and hedge any profitable economic activity that is beyond the scope of the conventional financial form of off-balance sheet securities (Mitchell, 2004; Basu, 2005). Securitization minimizes the cost of capital and mitigates the agency costs of market impediments (Jobst, 2005a). It is a process in which a bank or originator converts preferably stable and predictable cash flow streams in a segregated pool of rather illiquid financial assets (or collateral pool) into debt instruments (or securities or notes) that is tradable in the capital market (Huttenrauch & Schneider, 2008: 301). It aims to substitute capital market-based finance for credit finance by sponsoring financial relationships without lending and deposit-taking liabilities of banks (Jobst, 2005a).

2.1. Structure of Securitization Transaction

The most common types of securitization structure are true sale securitization and synthetic securitization. In the case of synthetic securitization, the originator does not seek to fund. So, the assets remain on the balance sheet. It is used by the originator as the protection against default from a receivable pool. Using credit derivatives, such as credit default swap (CDS), only the credit risk from the portfolio is transferred to the investors. It helps the MFI as the originator to reduce risk and diversify it. Synthetic securitization is used for regulatory capital relief (Glaubitt et al, 2008). It allows the originator to expand its balance sheet by making more loans with a given amount of capital. As the MFIs explore funding alternative rather than regulatory capital constraints, true sale securitization is suitable for them. So our analysis will be limited to true sale securitization.

True sale securitization entails the full sale of originator's designated assets to bankruptcy remote special purpose vehicle (SPV). The SPV issues securities with principal and interest repayments from the underlying assets. The sale of assets to the SPV removes them from the originator's balance sheet. It enables the originator to collect additional funding. The structure of the securitization transaction is presented in figure 1.

Figure 1: Structure of a typical true sale securitization transaction



Motives for Securitization

We can evaluate the motives for securitization as the general motives and MFI specific motives for securitization.

2.2 General Motives for MFI Securitization

The motives for securitization are diverse based on growth and state of development of MFI and the environment in which it operates. Table 1 presents the general motives for securitization from the viewpoint of the bank or corporation.

During the last few years, as subsidized form of donor supports and grants are drying up in microfinance industry increasing competition in the local market and rapidly growing loan portfolio push the MFIs to reduce their funding costs. Sometimes, the state law pushes the MFIs to impose a cap on their interest rates on the microloans. A group of leading MFIs also does not have a banking license. In such situation, the MFIs in developing countries step toward securitization in order to access to the capital market through which they can diversify their funding sources to improve their liquidity positions. However, their motives are quite diverse depending on the stage of the MFI growth, state of MFI development, and macroeconomic and legal environments in which the MFI operates (Glaubitt et al., 2008).

Table 1: General motives for securitization

Originators' (Bank/MFI/Corporate) viewpoint:	
Funding & liquidity requirements:	• To raise funds at low cost than the seller achieves itself. • To reduce asset-liability mismatch by eliminating funding exposure in terms of both duration and pricing basis. • Able to lower or remove assets from the balance sheet when required to lower capital while maintaining "earning power" of the assets.
Risk Management:	• Lock both the risks of loss and benefits of supernormal profit. • Free up and transfer the risks form the equity. • Improve the risk profile and to achieve corporate rating upgrades.

Balance Sheet Management:	• Balance sheet management by removing the assets (or any related liabilities) from the balance sheet. • Reduce financial covenants • Reduce disclosure requirements of the sellers/servicer's financial information or operations. • Uncouple lending growth from the capital base. • To bring capital adequacy in line with the regulatory requirements (to free up regulatory capital).
Investors' viewpoint:	
	• Potentially earn a higher rate of return on a risk-adjusted basis. • Increase return on equity (ROE). • Opportunity to invest in a specific pool of high-quality assets. • Diversification of portfolio. • Isolation of credit risk from the parent entity.

Source: Huttenrauch & Schneider (2008), Glaubitt et al. (2008), Jobst (2005b), Jobst (2006), Giddy (2000), Hossain & Khan (2005).

MFIs can use securitization to overcome funding barriers such as relatively smaller size of deposit base. Some top-tier MFIs have successfully issued debt instruments in the local capital market based on the third party guarantee (by IFC, USAID, FMO, and KfW). Examples are Mibanco in Peru, Financiera Compartamos in Mexico, Pro-Credit bank in Bulgaria, Compartamos in Mexico and Fin America in Columbia and the NGO affiliate WWB in Cali entered to the local and international market. Many MFIs are unrated despite the increasing professionalization of microfinance rating agencies (Sinha, 2008). Majority of the microloans issued by the mature MFIs are financed by deposits (Glaubitt et al., 2008). According to USAID estimate (2005), 15 to 25 percent of the liabilities of mature MFIs consist of external medium to long-term debt that comes from debt financing of their microloans through local deposits (Glaubitt et al., 2008). Through securitization, an MFI can remove the loan from its balance sheet while keeping the equity constant. It helps the MFI to leverage its regulatory and equity capital. The ABS transaction removes the loans from the balance sheet of the MFIs. It helps to improve financial flexibilities of MFIs that enables the MFIs to manage a larger loan portfolio without requiring equity (Glaubitt et al., 2008). Securitization helps to minimize their cost of funds and to manage their capital base more efficiently (Huttenrauch & Schneider, 2008; Glaubitt et al., 2008). Therefore, securitization can bring many benefits to MFIs such as:

a. Relatively cheap funding on a continuous basis
b. Increasing access to capital market
c. Diversification of the funding sources
d. Way to increase outreach and free up capital
e. Long-term funding
f. *Building good reputation*

III. Results

3. Case Study: Example of Successful Microfinance Securitization

3. 1. A True Sale and Cross-Border Securitization (Pro Credit Bulgaria)

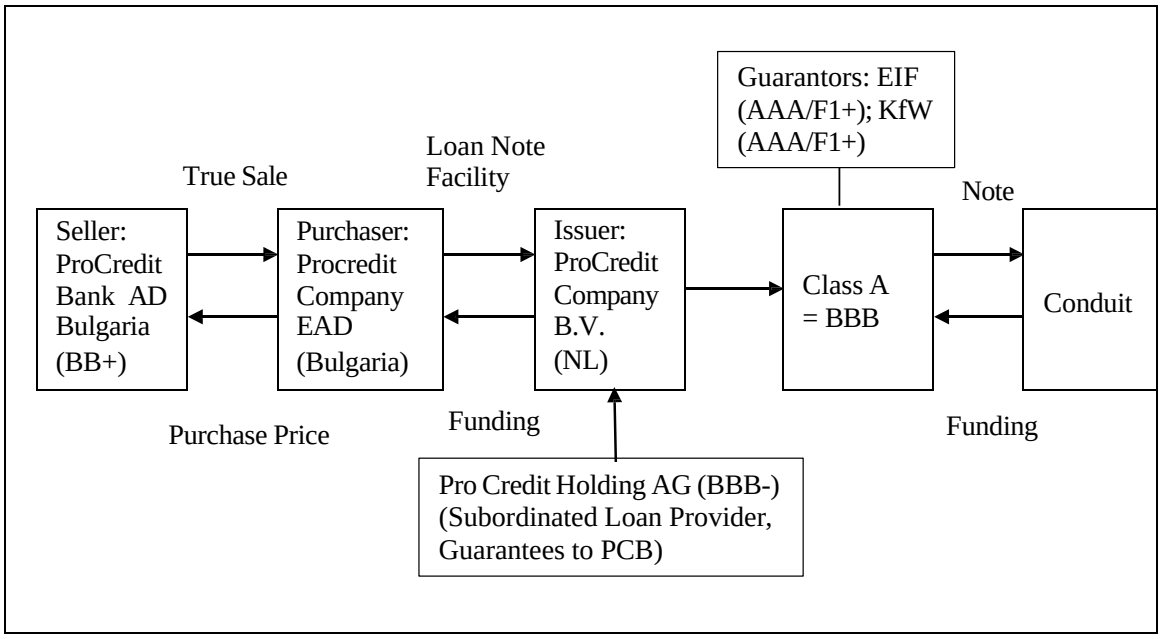
An example of true sale and cross-border securitization in microfinance is securitization of micro and SME loan by Pro Credit Bank Bulgaria. This securitization illustrates how basic securitization can be designated to overcome the actual challenges of securitizing the MFI assets. The transaction launched the entry of the Pro Credit network into the international asset-based securitization market and was structured and arranged by Deutsche Bank AG. From the beginning, German organization KfW supported the transaction ensuring the securitization structure compatible with the objective of capital market development (Huttenrauch & Schneider, 2008; Glaubitt et al., 2008).

In April 2006, Pro Credit Bank AD Bulgaria (PCB Bulgaria, the MFI) securitized part of its loan portfolio to micro-entrepreneurs, small and medium enterprises. Deutsche Bank did the transaction. KfW and European Investment Fund (EIF) provided credit enhancement. The initial securitization of the portfolio amounted to EURO 47.8 million and its target volume is EURO 100 million (Fitch, 2006c).

The innovative structure in this process combined the elements of a true sale securitization and an asset-backed commercial paper (ABCP) program. The securitization was structured as a two-tiered, multi-issuance platform: one SPV was established in Bulgaria to purchase the loans from PCB, the other SPV was set up in the Netherlands to issue the notes (Huttenrauch & Schneider, 2008). Below is the summary of such securitization structure:

- The originator, PCB Bulgaria, sold and transferred a portion of its loan portfolio to Pro Credit Company EAD, a Bulgarian bankruptcy remote SPV (purchasing SPV) for loan proceeds with a revolving promissory note. At the closing, the Euro-denominated asset pool consisted of 1,286 loans to SMEs and micro-enterprises.
- The amount of revolving promissory note was adjusted monthly to reflect the current balance sheet of the securitized loan portfolio. The issuing SPV, in turn, refinanced the notes through the issuance of senior notes, sold respectively to the Deutsche Bank ABCP conduit and through a subordinated loan by Pro Credit Holding AG, a Frankfurt-based parent company. Through the conduit, the Deutsche Bank sold ABCP to investors. The following figure 2 illustrates such securitization structure.
-

Figure 2: True sale securitization by Pro Credit Bulgaria (May 2006)



The noteworthy risk mitigation features in this transaction are (Huttenrauch & Schneider, 2008; Glaubitt et al., 2008; Fitch, 2006c):

- The pool was structured into senior and junior tranches for subordination purpose comprising approximately 95% and 5% at first closing.
- EIF and KfW provided a guarantee on the principal and interests for the senior notes, raising their rating from BB to AAA.
- Through credit enhancement, the Deutsche Bank ABCP conduit could buy notes with the best credit quality and rating. Deutsche Bank was able to purchase the guaranteed senior tranche through an Irish conduit and sold the commercial paper to investors.
- There was performance trigger indicator. A cumulative default trigger is activated whenever the PAR > 90 during the last 12 months exceeds 2.5 percent of the average portfolio. Also delinquency trigger would likely to activate when PAR > 1 day exceeds 1.5 percent of the portfolio. If the portfolio quality declines, these two criteria help to mitigate it. If such threshold triggers, the flow

- of funds into the portfolio is immediately suspended and the entire portfolio becomes due immediately. In such situation, the bank would have to buy back the portfolio.
- A loan to the end obligor may not exceed more than 6% of the total pool volume. New loans regularly placed into the pool have to be audited regularly.

Benefits from such securitization are manifold for the PCB:

- The transaction facilitated the originator to access to finance for the new target group of clients, particularly in rural areas of Bulgaria where they have a strong operational base.
- It allowed the PCB to tap indirectly into the international asset-backed commercial paper market (Fitch Rating, 2006c).
- It also helped to remove assets from the PCB's balance sheet reducing its total loan portfolio. This allowed the PCB to serve their micro entrepreneurs and SME clients without exceeding Bulgarian National Bank's (BNB's) growth limit (Glaubitt et al., 2008). When BNB relaxed the reserve requirements on lending, PCB continues to benefit from the resale of economic and regulatory capital provided by the transaction (Glaubitt et al., 2008). The revolving structure has allowed PCB to refinance newly originated eligible loans on an ongoing basis by selling them to Bulgarian SPV.
- From the demand side of the MFI, it helped to improve access to financial services for their clients in rural areas that in turn contribute in employment growth and poverty alleviation (Glaubitt et al., 2008).
- It also translates into lower borrowing costs.

However, to make the securitization transaction most effective, the MIS and IT system have to be adequate and good credit technology must be in place. Such true sale securitization is mainly suitable for large and mature MFIs.

3. 2. Domestic Securitization of Microloan Portfolio (BRAC in Bangladesh)

The world's first domestic securitization of microloan portfolio is the BRAC's Microcredit Securitization Series I closed in September 2006 in Bangladesh (Zaman & Kairy, 2007). At the time of securitization, BRAC was serving more than 5 million members; most of them are women. BRAC is an NGO specialized in microfinance established in Bangladesh and expanded its operation in 12 other developing countries. Since its establishment, this is probably the largest NGO type MFI in terms of its scale and diversity of operation. The average loan balance per borrower is USD 165.

The main objective of such securitization is to diversify the funding sources of this MFI at lower cost (interest rate) through pooling its microloan portfolios through asset-backed securitization (Eugenia, 2013). Through this breakthrough securitization, BRAC was able to access to an equivalent of USD 180 million local currencies funding over a six and a half year (Siddique et al., 2006). This complex securitization structure was mainly arranged by RSA Capital, a small financial advisory firm based in Dhaka and Boston. FMO (Deutsche Development Company) and KfW through its regional Asian securitization and legal department are the structuring investors who provided substantial inputs to the financial and legal structure of the transaction. Citi Bank NA worked as the co-arranger. Cliffed Charge (based in Hong Kong) and the local law firm Lee, Khan, and Partners acted as the legal advisor who generated the documents.

Under this securitization, FMO purchased the trust debt certificates of USD8 million in local currency. Simultaneously, with a solid guarantee for FMO and KfW, Citi Bank NA purchased debt certificates for the counter value of USD 22 million in local currency from the trust. Finally, Citi Bank NA, together with two other local banks, purchased the remaining USD 5 million of the certificates without a guarantee (Zaman & Kairy, 2007). The structure of such securitization is shown in Figure 3.

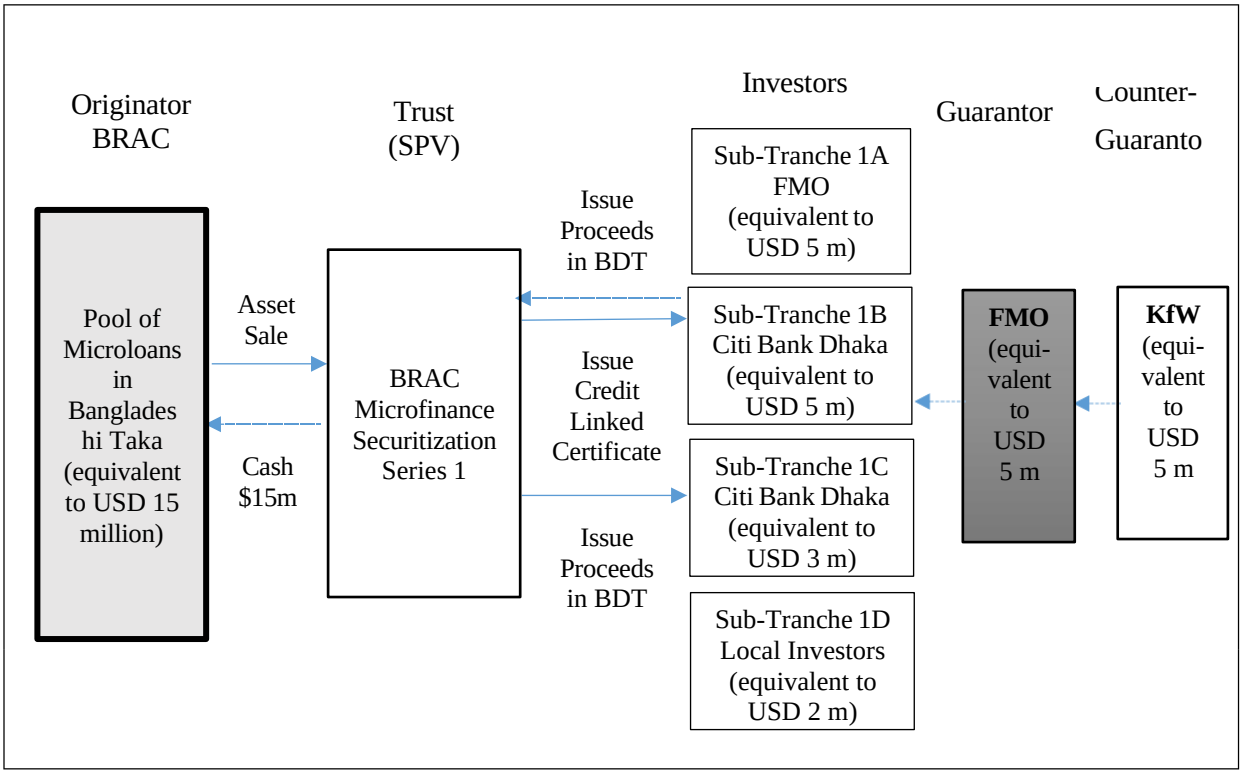
Under such program, BRAC assigned microloan receivables to BRAC microcredit securitization series I, an SPV established as a trust which issues certificates to investors representing undivided beneficial interests in the underlying assets. International Financial Review awarded such securitization as the "Securitization Deal of the Year 2006".

Key features of this securitization are (Glaubitt et al., 2008; Siddique et al., 2006):

- Each tranche in this securitization was collateralized by a pool of unsecured eligible microloans that was purchased by the SPV from the originator in each issue. Scheduled maturity of each of the issue of securities was one year. The securities were floating rate notes and tranche specific in their pricing based on the Treasury bill rate.

- Each tranche in this ABS was based on tens of thousands of microloans. It was estimated that over the lifetime of the transaction, approximately 3.3 million microloans would likely to be assigned to the SPV. In executing such large transaction volume, the Boston based company, MF Analytics with partial grant financing from KfW developed a software package to enable BRAC to generate the pools that have similar characteristics ensuring asset diversification across product type and geographic region.
- This securitization required the central bank to rate the structure by a local credit rating agency, CRAB. This first ABS issue obtained AAA rating on a national scale (CRAB, 2006).

Figure 3: BRAC Securitization Structure (2006)



The deal was structured in such a way that it contained several risk mitigation techniques:

- BRAC replaced all non-performing loans in the trust. As a servicer, BRAC was required on each issuance date to assign additional receivables to the SPV equal to 50% of the purchased asset pool.
- All parties have agreed on a one-month debt service reserve account (DSRA) at all times.
- Excess cash flows would be blocked in the trust for repayment to FMO-KfW and Citi Bank NA if BRAC cannot meet its contractual obligations.
- The transaction was structured in local currency which helped BRAC to eliminate exchange rate risk. It also helped to mitigate country risk as the funding was in local currency and local banks purchased part of the securitized assets. This is because there is complexity in central bank rule in approving foreign currency loan.
- BRAC also act as servicer and collector of principal and interests of the ABS on behalf of the trust and then transferred it on regular basis. BRAC's market reputation and positive track record in microfinance activities helped to accept it as the servicer.

This securitization has shown some positive benefits to the MFI (BRAC) in the following ways (Huttenrauch & Schneider, 2008; Glaubitt et al., 2008):

- It enabled BRAC to diversify its funding sources at a lower cost.

- In exchange for selling asset pool to on-shore and off-shore SPV, the MFI received cash flows both in local and hard currencies. All transactions were structured in local currency, which eliminated exchange rate risk for BRAC.
- This funding neither constitutes MFI's new funding liabilities nor created any obstacle on its borrowing limits. Selling such assets to SPV reduced total assets from the balance sheet as the funds raised would reduce liabilities.
- The sale of the pool of risky assets improved the risk profile of the MFI that in turn improved its financial standing.
- The more the risks and rewards of the aggregate asset pool are transferred from the balance sheet to the SPV, the more possibility to free up the economic and regulatory capital formally tied up. It improves the cost efficiency of the MFI giving it more opportunity to invest.
- As the pool structured was revolving and dynamic, the MFI was able to immediately refine the newly originated assets.

IV. Discussion

4.1 MFI Specific Requirements for Securitization

Any MFI, which wants a securitization, must have to respond to the requirements discussed above. Securitization is a sophisticated transaction and funding alternative which is much dependent on the data requirements. MFIs need to examine whether they fulfill the criteria for securitization and to what extent they comply with them. To evaluate to what extent MFIs match such requirements and what type of MFIs go for securitization, we need to examine the characteristics of the MFIs, their adaptability as the originator and servicer, their asset and liability structure, and the relevant data.

4. 2. Overall characteristics of MFIs

Microfinance market is highly fragmented. Different types of MFIs operate in different macroeconomic and regulatory environment. We can divide MFIs on the basis of leading technology, top-tier MFIs, growth potentials, and the size of loan portfolios. Their institutional setting is also different that include tiny microloan programs, sophisticated non-government organizations (NGOs) specialized in microfinance, commercial MFIs and commercial banks are created specifically to provide the customer base of microfinance with a broad range of retail financial services along with other traditional financial services. However, the majority of the MFIs face the problem of weak institutional setting, the limited scope of growth potential due to the lack of self-sustainability and donor dependency – all of which have little chance to achieve economies of scale (Littlefield & Rosenberg, 2004).

Only a few MFIs are commercially viable. These top-tier MFIs are professionally managed, have been operating for more than five years, have sufficient track record of making a profit, and originate microloans and administer their portfolios according to generally accepted underwriting and servicing principle (Huttenrauch & Schneider, 2008).

4. 3. Qualification of MFIs for Securitization?

The MFIs, which want to obtain fund through securitization, must qualify for it. The previous section discussed the general requirement for securitization. Here we will check how the MFIs qualify for securitization based on some important criteria.

a. MFI's origination and service quality

The first criterion to consider is whether the MFI qualify as the originator or servicer. In this case, it is important to consider the rating of the MFIs to ensure that the MFI and its underlying assets are capable to originate SPV for securitization and it will not fall into bankruptcy position in servicing the securitized assets. For this, it is important to rate the MFIs either by international or local rating agencies.

It is estimated that 150 to 300 MFIs have either international or local rating (Huttenrauch & Schneider, 2008). It is difficult to define the average rating or average credit quality of the top-tier MFIs because the rating scales of different rating agencies are not completely comparable. Moreover, due to the rating caps imposed by the respective countries, many of the top tier MFIs, which were awarded by international rating agencies, has a meaningful rating. Many of them are rated by local agencies. We can consider all of these MFIs for this purpose considering country-specific and MFI specific conditions.

But for the unrated MFIs, securitization is difficult. So they become rated institutions or try to find rated back up servicer. Back up servicer take steps in which the servicer to the securitization is downgraded to a predetermined rating level or when the servicer defaults. If the servicer declares bankruptcy or liquidated, the underlying assets will be severely affected. MFI's transaction is not automated, and they are dependent on the personal relationship between the debtor and the originator or servicer (MFI). So they require back up servicer which is mainly one of the rated competitor in the same country or a strong MFI in the neighboring country with similar business language, underwriting and servicing technology (Huttenrauch & Schneider, 2008). But the problem is when the MFI considers such backup servicer local MFI as a competitor or rival, are reluctant to provide a full set of required data. To overcome such difficulties, it is better to use back up servicer belonging to the same MFI network.

All the MFIs are not capable of providing servicer in securitization. However, most of the top-tier MFIs' operational results are convincing, hence, qualifies as servicers. Their reported loan losses and loan default are low; portfolio at risk (PAR) is also low.

In addition, MFI loan portfolio is characterized by small loans with short-term maturity with a frequent collection of repayment from clients. It requires updated tracking of defaults and delinquencies as it is common and frequent. Hence both the MFI and the third party servicer need to ensure sophisticated transaction reporting through an updated management information system (MIS) ensuring quality accounting standard. The MFIs need to update their IT system to ensure it. The MFI's information system must be capable of separating each securitization loan from the others within the asset pool on a loan by loan basis tracking their delinquencies, default, repayments, cash balance and restructuring of both the securitized and un-securitized assets (Huttenrauch & Schneider, 2008).

b. Diversification and Standardization of MFI Assets

MFIs have a large number of relatively small loans in their portfolios. Hence the loan portfolios are highly granular. The main requirement for securitization is whether the loan in the portfolio is homogenous and sufficiently standardized. Maturities of these small loans are relatively very short, 3 to 12 months. Average loan size ranges from USD50 to 5000. The underwriting policies are very informal. Most of the loans in MFI portfolio are traditional microloan without physical collateral except group guarantee or savings deposit or informal business. They follow a single set of underwriting and collection policies which make the asset pool standardized. However, microloans are possible to use as ABS as they are collateralized by the cash flows and the performance of the high profile operating track due to their strong market reputations. But if the loan products are different with different underwriting policies, they are not suitable for securitization. This problem can be overcome if there is a sufficient number of the loans of each product group as sub-pool to put them into different tranches.

c. Data Requirements

Investors and rating agencies want to model the predicted cash flow from the different loans of the potential assets pool under different stress scenarios. For this, the loan portfolio needs to be well diversified, homogenous and standardized for effective grading. For grading purpose, the modeling exercise requires the following on a loan by loan basis: the original loan amount, current outstanding loan balance, and days to maturity, interest rate, and collateral, previous repayment records, seasoning of the loan and repayment schedule (Huttenrauch & Schneider, 2008). The rating agency evaluates the cash flow behavior of the portfolio under harsh situation or stress scenarios by analyzing the MFI's capability as well as creditworthiness of the borrower using credit scoring and historical data over a business cycle. For this, availability of information on microloan portfolio is very important.

Securitization opens a new horizon that overcomes the funding barriers of microfinance on the eve of shrinking donor funding. As the shift to capital market-based lending lead to a close link between primary and secondary market (where loan portfolios are traded), securitization of the asset pool of microloan portfolio permits the MFIs to provide financial services to those, who do not have access to formal financial systems. It allows

MFIs to enter the international capital market. In this paper, we analyzed how securitization can be used in funding MFIs portfolio and what are its benefits.

Securitization has a clear positive influence on the MFIs. An ABS transaction removes the loans from the balance sheet of the MFIs. It improves their financial flexibilities and enables the MFIs to manage a larger loan portfolio efficiently and at low cost requiring less equity. It helps the MFIs to diversify their risk profile through transferring their credit risk of a pool of microloan to investors in domestic and foreign markets. It has a positive influence on the economic development. Securitization helps to enlarge MFIs' loan portfolio that help them to expand their outreach. MFIs will be able to serve in rural areas. The reduced funding cost will help to minimize the cost of the loan (interest rate) to the micro entrepreneurs contributing to improving their income levels. It enables the MFI to lengthen maturity profile, permitting long-term planning and diversified product offerings. Through securitization, domestic investors are able to invest in MFI that help to redirect rural savings from the urban areas that help to boost up rural savings and resource mobilization. Also, the creation of a domestic secondary market through securitization and risk diversification will deepen and broaden the local financial system. Development of a more liquid secondary market for microfinance and efficient mobilization of funds will contribute to poverty alleviation as more poor people will gain access to financial services at lower cost.

From the MFI side, ABS gives the MFI very strong market-driven incentives to perform well (Glaubitt et al., 2008). Due to the precondition of securitization, loan portfolios are standardized, loan origination and monitoring process made efficiently; data processing and warehousing requirement by the rating agencies make them efficient and up to date. From the investors' viewpoint, emerging microfinance asset class attractive due to its appealing risk profile. Granularity, diversification, standardization, low prepayment risk and relatively low default rate and lower historical loss rates are the plus points for the ABS investors (Huttenrauch & Schneider, 2008). Due to specialized credit technology, MFI portfolios are extremely performing well that attracts private investors in this sector.

However, securitization in microfinance is not free from limitations. There are many complexity costs involved in securitization of such transaction if it is a single securitization. Particularly there are upfront costs associated with data processing, legal expenses, rating fees, high-risk premiums on initial ABS issuances and reputation building. Through repeated securitization, these costs can be minimized. There is the risk of default of the assets pool used for securitization. This may involve structural and operational risks created from information asymmetry, changes in market interest rates or exchange rates, and changes in or inadequacy of the legal systems of the country. The originator may abuse securitization by using it for money laundering or the managers may abuse it for their personal economic incentives by tempting the pricing of the underlying assets (Reis-Roy, 2007; Jaafar & Basri, 2017). Proper legal system and careful structuring of the deal by applying proper risk mitigation technique can overcome such problem. Further research in this area may involve a study exploring the empirical impacts of securitization of MFIs and identification of local market influences in different parts of the globe.

V. Conclusion

Current study proposes a substitute for funding microfinance institutions which in turn enables a major tool that has been reported in this research earlier. The case of BRAC reported in this research provides a framework for this financial strategy. The findings may be of interest for managers in determining financial strategy for microfinance institutions around the world which in turn affects the survival of these institutions in a very competitive market.

VI. References

Basu, S. (2005). *Securitisation and the Challenges Faced in Micro Finance*. Institute for Financial Management and Research, Centre for Micro Finance Research, Working Paper Series, Mumbai, April. Retrieved from http://ifmr.ac.in/pdf/workingpapers/2/Securitization.pdf

CRAB (2006). *BRAC Micro Credit Securitisation Series I*, Preliminary Rating Report, February 28, Credit Rating Agency of Bangladesh.

Cull, B., Demirguc-Kunt, A. and Morduch, J. (2008). *Microfinance Meets the Market.* New York: Financial Access Initiative.

Denner, M. (2018). Stands on globalization, *Journal of International Business, Economics and Entrepreneurship (JIBE)*, *3*(1), 53-55.

D'Espallier, B., Goedecke, J., Hudon, M., & Mersland, R. (2017). From NGOs to banks: Does institutional transformation alter the business model of microfinance institutions?. *World Development*, *89*, 19-33.

Fitch Ratings (2006c). *Credit Products/Bulgaria: New Issue: Pro Credit Company B.V*. Fitch Structured Finance, 15 May. Available at: www.fitchratings.com.

Giddy, I. H. (2000). *Asset securitization in Asia*, ASIA Limited, Singapore. Available at: http://www.stern.nyu.edu/-giddy/ABS/abasia.pdf

Glaubitt, K.; Hagen, H. M.; Feist, J. and Beck, M. (2008). Reducing barriers to microfinance: The role of structured finance, in *New Partnership and Innovation in Microfinance*, (eds. Matthaus-Maier and von Pischke, J. P.): 349-378, Germany: Springer & KfW.

Hossain, S. & Khan, M.S.U. (2005). Recent global scenario of securitization: Problems and prospects of implementation in Bangladesh, *The Chittagong University Journal of Business Administration*, 20: 261-290.

Hüttenrauch, H. and Schneider, C. (2008). Securitisation: A Funding Alternative for Microfinance Institutions, in *New Partnership and Innovation in Microfinance*, (eds. Matthaus-Maier and Vonn Pischke, J. P.): 299-348, Germany: Springer & KfW.

Jaafar, M. N., & Basri, M. F. (2017). Corporate Social Performance (CSP) influences on Islamic Bank's financial performance, *Journal of International Business, Economics and Entrepreneurship (JIBE)*, *2*(1), 11-16.

Jobst, A. (2005a). *What is structured finance?* Working Paper, International Monetary Fund (IMF) and International Capital Market Development. Retrieved from http://ssrn.com/abstract=832184

Jobst, A. (2005b). *Asset securitization as a risk management guiding tool: What does it hold in store for SMEs?* SSRN Working Paper. Retrieved from http://ssrn.com/abstract=700262).

Jobst, A. A. (2006). Asset securitisation as a risk management and funding tool. What small firms need to know, *Managerial Finance*, 32(9): 731-760, (http://www.emeraldinsight.com/Insight/viewPDF.jsp?Filename=html/Output/Published/EmeraldFullTextArticle/Pdf/0090320903.pdf).

Littlefield, E. & Rosenberg, R. (2004). Microfinance and the Poor. Breaking down walls between microfinance and formal finance. *Finance & Development*, (June 2004): 38-40 Retrieved from http://www.imf.org/external/pubs/ft/fandd/2004/06/pdf/littlefi.pdf

Mitchell, J. (2004). *Financial Intermediation Theory and the Sources of Value in Structured Finance Markets*, mimeograph, National Bank of Belgium, December 2004. Retrieved from http://www.bis.org/publ/cgfs23mitchell.pdf

Reis-Roy, C. (2003). *An analysis of the law and practice of securitisation*. Retrieved from http://wlv.openrepository.com/wlv/bitstream/2436/14405/3/ReisRoyPhd%202007.pdf

Sinha, S. (2009). Market transparency: The role of specialized rating agencies, in *New Partnership and Innovation in Microfinance*, (eds. Matthaus-Maier and Vonn Pischke, J. P.), 49-68, Germany: Springer & KfW.

Sonal, A., & Soni, M. D. (2017). Changing contours of the Indian securitization market: Trends, issues, and the way forward. *Journal of Structured Finance*, *22*(4), 31.

Zaman, S. and Kairy, S.N. (2007). Building Domestic Capital Markets: BRAC's AAA Securitization, *Micro Banking Bulleting*, Issue 14(Spring): 13-15. Microfinance Information Exchange, Inc. Retrieved from http://www.mixmbb.org/ en/assets/MIX_2007_Spring_MBB14_Inside.pdf

.